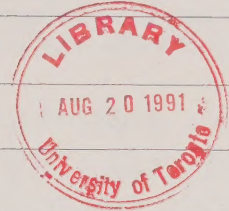


# 36

## SOVIET DEFENCE INDUSTRY REFORM: THE PROBLEMS OF CONVERSION IN AN UNCONVERTED ECONOMY

by Karen Ballentine



### INTRODUCTION

In December 1988, Mikhail Gorbachev made the issue of defence industry conversion part of the official *perestroika* agenda. In a speech before the General Assembly of the United Nations, he pledged to embark on a "transition from an economy of armament to an economy of disarmament." This commitment, and Soviet disarmament initiatives, suggested that deliberate defence conversion was no longer just a desirable goal, but was on the verge of widespread application by a major military power.

The definition of "defence conversion", or simply "conversion", is a matter of some debate in both East and West. In the broadest sense, conversion is a process of economic demilitarization that includes troop demobilization and reduced defence expenditure and weapons production. This definition describes in general terms the shift in priorities and resources from the military to the civilian economy, but usually falls short of explaining how this shift is to be effected. Instead, in practice, 'conversion' is more commonly employed by both Soviet and Western specialists in the narrower sense of a literal transformation of defence industrial capacities. Leading Soviet defence economist Vladimir Faltsman defines conversion as "the reorientation of defence plants to civilian production and the utilization of resources freed from the military for peaceful goals."<sup>1</sup> As described by the 1982 *UN Study on the Relationship between*

*Disarmament and Development*, conversion, in this narrower sense, seeks "to permit the smoothest possible transition to the production of socially useful goods and services."<sup>2</sup>

From this perspective, conversion is just one of several approaches to managing the economic consequences of a political decision to reduce arms. It is qualitatively different from diversification strategies developed by military industries to maintain viability in the face of significant defence cuts. Whereas diversification permits continued defence production alongside new civilian manufacturing, conversion more sweepingly demands the substitution of defence with civilian production. For Soviet reformers, conversion — with its emphasis on finding immediate practical civilian uses for the technical and scientific potential accumulated by the defence sector — appeared the preferable approach, particularly in the face of growing consumer shortages and infrastructure collapse.

Traditionally, Soviet officials maintained that the Soviet economic system would be better suited to such a conversion programme than any market system. Given its extensive planning apparatus and long tradition of interventionist economic policy, they argued that the Soviet Union could avoid many of the social and economic disruptions which would make demilitarization difficult in market economies. Centrally-planned conversion would be better coordinated and its benefits more quickly achieved. All that was needed





was a political commitment; implementation would follow in due course.

In fact, however, Soviet conversion has encountered formidable difficulties. Some of the problems stem from the sheer size of the Soviet defence sector and the growing disarray of the wider economy. Primarily, however, the poor progress of Soviet conversion is the result of the systemic depredations of central planning. Until and unless the entire economic process is opened to market forces, Soviet conversion efforts will continue to languish under the deadweight of the faltering but still tenacious command system.

## THE CASE FOR CONVERSION

While Gorbachev's disarmament initiatives have made conversion possible, Soviet economic decline has made it imperative. During the last fifteen years, the Soviet Union's military prowess was increasingly incompatible with its economic vitality. While the West was engaged in rapid technological advancement, Soviet industry was struggling with a decaying infrastructure and diminishing reserves of labour and raw materials.

Initially, Soviet reformers believed that the critical transition to technology and resource-intensive development could be effected without prejudice to the country's defence base. Much to their chagrin, the early, tepid policies of *perestroika* only exacerbated the decline. By 1989, the government budget deficit had reached 80.7 billion roubles or 11% of GNP, making it the highest budget deficit among leading industrial powers. Similarly, the modest external debt of 1985 rose by 400 billion roubles in just four years.

During the 1980s, civilian productivity declined and consumer shortages took on crisis proportions. According to some estimates, military spending claimed as much as 20% of GNP while forty-three million Soviets lived below the poverty line — a situation no longer economically nor politically tenable in the age of *glasnost* and mass politics.<sup>3</sup> Put simply, *perestroika* could only succeed with a comprehensive reduction of the massive defence burden and the release of defence resources for civilian needs.

## HIGH EXPECTATIONS AND MIXED RESULTS

As with the often exaggerated expectations of the "peace dividend" in the West, great things were expected of the Soviet conversion initiative. Indeed, it has often been held up as a panacea for all that ails

the Soviet economy. Infrastructure modernization, environmental clean-up, and educational improvements have all been cited in the Soviet press as anticipated benefits. In fact, however, Soviet conversion policy has been more limited in its application. The overriding priority has been to meet the urgent needs of the flagging consumer sector. According to official statements, the goal is to increase the volume of consumer goods and related industrial equipment produced by the defence industry to 270 billion roubles, or 60% of all defence industry output by 1995. To achieve this, the defence budget would be slashed 19% by 1991 from the 1989 official figure of 77.3 billion roubles, while more than 400 defence enterprises, 100 civilian plants engaged in defence production, and 200 research and design bureaus would be partially or entirely converted.

To some extent, official enthusiasm for these plans has been justified. The defence sector, though suffering some of the corrosive effects of Soviet economic decline, has consistently demonstrated higher levels of performance than its civilian counterpart. The defence sector's 5000 enterprises house some of the most advanced technology and industrial plant in the country, while its workforce of six to seven million includes the most highly qualified scientists and engineers.

Defence industry not only has the potential to contribute significantly to the civilian economy, it has long experience in producing consumer goods — large segments of it, in fact, are already diversified. Since 1965, an estimated 40% of defence industry output has been consumer durables. In 1988, this output covered a range of 2000 goods, including 62% of all washing machines, 95% of all refrigerators, and 100% of all televisions produced in the country. Defence enterprises also have participated extensively in the production of civilian transport, computer and electronic components and medical equipment. Under the impact of present defence cuts, it was hoped that conversion would effectively increase the volume, quality, and mix of these goods as well as enhance the means of their distribution.

Despite the major efforts of the last two years, conversion has yielded only marginal returns. Nevertheless, the official assessment has been positive. According to official data, the 1989 defence budget of 77.3 billion roubles was cut by 8.2% in 1990, including a 6-7% cut in allocations for defence production. Goskomstat, the state statistics agency, reports that in the first half of 1990, the defence industry increased production of non-food consumer items by 25%, even as other industrial production in the economy declined. Overall, heavy industrial output — which includes defence pro-



duction — is said to have declined by 3.2% in 1990, while consumer production increased 4.4%. Conversion also has been credited with a 30% reduction in the volume of strictly military manufacturing in the defence sector, thus freeing up additional capacity for civilian production. Finally, officials also claim that, thanks to the savings generated by conversion, the 1989 budget deficit was reduced by 22.6 billion roubles to 58.1 billion roubles in 1990.

These figures do not tell the whole conversion story. Consumer goods output, though up by 26.2 billion roubles in 1990, still failed to meet even half of its assigned target. Of the 120 new consumer items to be produced by defence facilities, only twenty-three actually went into production. Indeed, from the point of view of the Soviet consumer, the situation had changed very little from 1989, when 243 of the 273 basic items listed on the state consumer index were regularly unobtainable.

Perhaps even more telling, only some 500 defence firms have been harnessed to the conversion effort. Only fifty of the 500 have actually been slated for full conversion, and of these, only five or six have been converted. For those firms remaining outside the conversion process, military production lines have remained intact and the capacity freed by defence cuts sits idle. Furthermore, according to one independent survey, two-thirds of all plants refurbished in the last two years — most of which are defence plants — have been operating at less than half capacity.

Much of the relative increase in the defence industry's production of consumer goods can be credited to two factors other than conversion. The first is the expanded volume of civilian production lines which were already in place in defence enterprises. The second is the creation of "new" capacity for consumer goods production through the bureaucratic transfer of enterprises *from* the civilian to defence sector. In the first instance, while some redirection of defence resources has occurred, no restructuring has been required. In the second, the Defence Ministry has simply taken over floundering civilian concerns, a practice which began in 1988 with the absorption of some 345 enterprises from the dissolved Ministry of Machine-Building for Light and Food Industry — a practice which has since continued.

## CONVERSION WITHOUT REFORM

Conversion requires not just a reduction in military expenditure but also — and more importantly — a direct transfer of defence capacity to civilian use. Clearly, this has not been happening in the Soviet

case. As many Soviet critics are quick to point out, conversion has been largely a "fairy-tale, a myth," and that which is officially called "conversion" has been essentially a more comprehensive diversification of an already well-diversified defence industry. Instead of promoting the systematic and permanent demilitarization of the economy, conversion has, to borrow the expression of one Soviet commentator, been pursued as "the magic wand which our wretched economy can wave to rectify its condition." It is a strategy which seeks to compensate for the defects of the long-neglected consumer sector without addressing the roots of the country's economic problems.

It is worth emphasizing that, although defence conversion has been frequently presented as a natural component of *perestroika* and the move towards a market economy, from the outset the policy has been predicated upon the continued existence of the centrally planned system. Traditionally, the military-industrial complex has stood at the apex of that system and has been virtually the only sector capable of global technological competitiveness. Conversion was initiated in the belief that defence industry performance capabilities could be easily transferred or adapted to the production of civilian goods. All that was needed was a mere substitution of production under the auspices of the still centralized military-industrial complex.

This is an ill-conceived strategy because it fundamentally confuses bureaucratic effectiveness with economic efficiency.<sup>4</sup> The defence sector's higher performance was assumed to be something inherent rather than, as was actually the case, the result of its powerful administrative network and its politically sanctioned privilege of priority resource allocation. Such muddled thinking has proven costly. Not only has conversion failed to translate guns into butter, it has exposed the long insulated defence sector to many of the ills of the mainstream command system.

## BARRIERS TO CONVERSION AND THE SOVIET SYSTEM

### *Planning*

In addition to its conceptual flaws, Soviet conversion has suffered from poor implementation. For a system so dependent upon economic planning, it is paradoxical that Soviet conversion was initiated without a detailed and coherent strategy. As conversion advocates argue, for the process to be smooth and orderly, it is essential to determine precisely and in advance just what skills and resources defence manufacturers have and how they can be most



efficiently reoriented to civilian use. In the Soviet case, a study of the defence base and alternative uses for its facilities began some six months *after* conversion had begun at the industry level. In August 1989, the USSR Congress of People's Deputies set the end of the year as the deadline for an elaborated programme. A year later, the state law on conversion finally was passed but in the view of many reform-minded economists, its vague and conservative provisions hold out little hope for redeeming the promise of conversion.

One reason for the absence of a comprehensive programme no doubt stems from the urgency of the worsening economic crisis. Soviet planners have asserted that the economy simply could not afford the two years which alternative-use planning requires. But conversion planning would also require more decentralized decision-making at the enterprise level and the removal of the traditional secrecy regulations which pervade the defence industry. As even Gorbachev has complained, such regulations act as a barrier to information and technology flows to the civilian sector. Predictably, such institutional change has been resisted by entrenched interests within the military-industrial bureaucracy which seek to preserve the centralized and privileged position of the defence sector. Rather than allowing initiative and direction from below, the defence establishment has fought successfully to maintain planning from above. In effect, conversion has been implemented by those elements which are least interested in its success: Gosplan, the Military Industrial Commission, and the defence ministries. Under their combined influence, conversion has been carried out by *ad hoc* administrative decrees without the benefit of either legislation or public accountability.<sup>5</sup> Despite two years of conversion activity, the basic questions of which plants are best suited to conversion, how they are to be financed, and to what they should convert, have remained unanswered.

This centralized approach to conversion has had serious repercussions for the defence industry. In the absence of rational preparation, the impact of ongoing defence cuts has been impossible to predict let alone remedy. Many defence enterprises were apprised of the changes to their production profile only three to six months in advance and the new orders were not accompanied by alternative sources of supply or investment. Likewise, scant attention was paid to existing enterprise capacities so that many highly specialized and technologically sophisticated plants were compelled to produce rudimentary consumer goods: shoes instead of MIG-29 engines or dried fruit packaging instead of combat helicopters. In some cases, the irrationality of this approach was

compounded by a failure to take into account the impact of new consumer targets on still binding defence production quotas. As a result, enterprises halted their defence production to meet pressing civilian orders only to face stiff fines for non-fulfilment of the defence plan. Such continued centralized constraints and the neglect of actual enterprise feasibility have worked to create some of the very economic and social dislocations which conversion seeks to avoid.

### *Financing and Supply*

The Soviet defence industry has traditionally owed its survival to an elaborate system of generous subsidies and guaranteed state purchases. As a result, Soviet defence enterprises have been spared the Soviet economy's systemic inefficiencies of distribution bottlenecks and supply scarcities. Unlike other sectors of the economy, defence has enjoyed a priority position in resource allocations and unique horizontal ties which have allowed enterprises to circumvent many of the bureaucratic rigidities of the command system.

With the onset of conversion, however, this preferential arrangement has been steadily undermined. Defence enterprises now must cope not only with significant losses in defence production revenues and the erosion of traditional supply networks, but also with new state orders for consumer goods for which adequate sources of financing and supply have not been made available. Much of the money that was initially freed by defence cuts was not translated directly into funds for conversion but instead went to other claimants such as the budget deficit. In fact, during the first year of conversion, there was no additional funding whatsoever because Soviet planners believed that conversion would be self-financing.

The Soviet experience, however, has proven that centrally-planned conversion is a very costly exercise. Despite decades of massive financial injections, many branches of the defence industry are hindered by outdated capital stock. According to one defence representative, up to one-third of the industrial equipment in the Soviet aerospace industry was built before 1940. Among civilian enterprises absorbed by the defence ministry in 1988, the figure is 60%. Even among those enterprises with relatively modern equipment, defence planners have quickly discovered that the technological gap between weapons system production and consumer goods assembly lines cannot be easily nor cheaply bridged.



In response to these increasingly obvious costs, provisions were belatedly made to provide state funding. In 1990, an emergency subsidy of 330 million roubles was given to the defence industry in an attempt to offset lost revenues and prevent widespread bankruptcy. In the same year, the state budget allocated 4 billion roubles to conversion proper. According to the current programme for conversion, a total of 60 billion roubles will be allocated over the 1991-1995 period.

These allocations have not been sufficient to cover the costs of conversion and desperate defence managers have been forced to search for alternative sources of investment and supply. However, the system provides few alternatives; outside the confines of central planning, well-developed wholesale commodities or financial markets simply do not yet exist. Suppliers continue to be bound by the inflexible system of state orders and cannot legally engage in direct trade until these obligations have been met. Where they exist at all, investment resources have been similarly constrained. Despite new laws that permit enterprises to dispose of a greater percentage of their earnings, the ministries continue to dictate investment priorities.

In order to circumvent these barriers, some defence managers have resorted to the black market, where materials are more readily available but at inflated and often hard currency prices. To compensate for these additional expenses, many have diverted revenues from production bonuses, thereby provoking worker dissatisfaction and undermining their competitiveness. Not surprisingly, the high costs of production, which are made worse by the higher overhead of defence facilities, have made the prices of many of their consumer goods uncompetitive. According to one study, a simple electric pump produced by a defence plant costs 3,412 roubles while a comparable civilian made pump costs only 180 roubles. Overall, the financial costs of converting defence enterprises have become so great that defence managers now warn that without further funding from the state, conversion cannot be sustained.

### *Manpower Problems*

Ideally, conversion results in the reorientation of production with minimal labour dislocation. Indeed, preventing massive job losses in the wake of defence cuts, and thereby removing a potentially powerful source of political resistance to disarmament, is one of conversion's most important objectives. However, in the Soviet case, the lack of adequate funding has had serious consequences for defence workers. Many cash-starved enterprises have had to curtail allocations to their social and housing funds. In some cases,

wages have also been cut. At other plants, wages have been maintained only with massive state subsidies.

Accustomed to a relatively high standard of living, nearly half a million defence workers have responded to this decline by seeking employment in the more lucrative cooperative sector of the economy. In terms of shifting labour to the civilian economy, this trend is indeed consistent with the wider goals of conversion. However, as many defence officials complain, they are losing some of their most talented and experienced specialists. While it may benefit the cooperatives, and eventually the wider economy, this "brain drain" has impaired the performance of the defence industry as well as its ability to creatively and efficiently adapt to civilian activity.

There is also concern that both continued cuts in procurement and subsidies, and more stringent regulations for enterprise cost-effectiveness will lead to widespread insolvency and large scale unemployment. To be sure, such painful adjustments may be unavoidable. In current Soviet conditions, however, the potential for this trend to become politically destabilizing is far greater than elsewhere because — apart from the relatively small and uncertain cooperative sector — the surrounding economic environment cannot easily absorb large numbers of released defence workers. By 1990, the switch to enterprise self-financing had resulted in an unprecedented 3.5 million lay-offs. According to state officials, the number of unemployed could double in 1991 and may rise as high as seventeen million by the end of the decade. At the same time, while there were two million unemployed workers at the start of 1991, there were three million jobs available in the main production branches of industry. This paradox is explained by the lack of correspondence between the location of the jobs and the available labour. While there is a labour market of sorts, there is little labour mobility. At fault is the near feudal system of internal passports which, though not entirely inflexible, works to discourage natural population movement and labour redistribution.

This lack of flexibility is compounded by the fact that conversion was initiated with little concern for worker protection. Indeed, until recently, the Soviet system generally did not have any social welfare arrangement that provided workers with unemployment benefits since officially, there was no unemployment. Although the new legislation promises the unemployed an alternative means of subsistence, it contains no specific measures to meet the needs of retraining defence workers. As such, it only goes part of the way in alleviating the concerns which predispose defence workers against conversion.



Soviet conversion policy has likewise failed to provide mechanisms that could ease the resistance of conservative defence industry managers. Like defence managers everywhere, Soviet managers have become accustomed to a monopsony system of production in which financing is guaranteed in advance, there is a single customer with known preferences, and the chief criterion for production is performance at any cost. Defence managers thus suffer from what Seymour Melman has termed "a trained incapacity for civilian production." They have neither the marketing skills nor the cost awareness which could help them adapt to the new criteria of civilian production: affordability, utility and uncertain consumer demand.

In the Soviet case, the management barriers to conversion are more resilient than elsewhere. The products of a system which traditionally has rewarded conformity at the expense of innovation, Soviet defence managers are highly averse to change, particularly where change involves risk. In what may be a telling illustration of how this ingrained conservatism works against the very rationale of conversion, one defence manager at a gathering on conversion enthusiastically declared that "the tasks set by the Party will be fulfilled at any cost."<sup>6</sup>

Undoubtedly, the prevalent conservatism of defence managers is due in part to their desire to protect their privileged and secure positions — indeed their very *raison d'être*. However, it is also true that their antipathy to conversion has been unwittingly reinforced by the demands of central planning.

Traditionally the first responsibility of defence managers has been to fulfil state orders for military-related products. Wherever civilian manufacturing has coexisted with defence production, it has taken second place. Indeed, civilian manufacturing has long been viewed by defence managers as less prestigious and less profitable; a necessary and hopefully temporary task assigned from above and, therefore, impossible to refuse. Despite all of the official exhortations on the benefits of conversion, this view has not changed. Defence managers continue to place defence production first and they do so because it is fulfilment of the defence plan that determines their salaries.

Overall there has been little effort to correct this situation by creating positive, primarily financial incentives to switch to civilian manufacturing. True, defence plants have been permitted to retain the profits of any above-plan civilian production, but few have been able to meet those targets due to the supply and financial problems. As far as the revenues

from planned civilian production are concerned, defence plants are compelled to pay an exorbitant 70% tax to the state. Even more burdensome, because centrally defined plans are legally binding, defence plants cannot reject orders for civilian goods that are inappropriate to their facilities or simply unprofitable.

Perhaps the only incentive to conversion is the perception that civilian production could become profitable in the longer term. Some of the more enlightened defence managers and specialists have sought to defy the odds imposed by central planning with self-initiated innovations such as local information exchanges, leasing agreements, and joint ventures. But such spontaneity from below continues to be resisted by central ministries where old methods predominate, and by the majority of defence managers, for whom conversion is not a test of their entrepreneurial zeal but rather a complicated and losing proposition. In view of the losses in guaranteed contracts and revenues, the disruptions in productivity, and the steady outflow of specialists, it is no wonder that managers now openly condemn conversion and demand that the state restore the *status quo ante*.

## CONVERTING CONVERSION

All sides of the Soviet political spectrum now concede that if conversion is to succeed, current policies must be drastically revised. There is, however, considerably less consensus as to what revisions are needed. Essentially two schools of thought prevail: the 'liberal', which seeks remedy in bringing market forces to bear upon the defence industry; and the 'conservative' which would make conversion contingent upon revitalized central planning.

The liberal approach has been advocated by the Soviet National Commission for the Promotion of Conversion, as well as by such reform-minded economists as Stanislav Shatalin and Nikolai Petrakov. According to their analysis, the conversion of the Soviet economy requires a massive structural shift and an end to the rigid separation between its defence and civilian sectors. As a first step, the entire economy must become more firmly market-driven so as to create a receptive and responsive environment for conversion. Secondly, the defence sector must be brought into this process. As one defence critic has stressed: "It is not possible, within the single complex of the Soviet national economy, for one part to shift to the market while another remains within the centralized command system. It is this monopoly control of the military-industrial complex which constitutes the principal brake on the future market economy."<sup>7</sup>



The main thrust of the market strategy is to release a portion of defence enterprises from the bureaucratic stranglehold of the central ministries. Whether accomplished through joint-stock companies, co-operatives or joint ventures, this privatization would encourage enterprises to undertake conversion by responding directly to the needs and opportunities of the market. At least during the initial phase, only part of the defence sector would be affected—perhaps 20-30% of its enterprises. The remainder would continue to operate on a state-run and unconverted basis; however, their production would be rationalized through the replacement of rigid state orders with a system of competitive defence contracting. The role of the state would be limited to the provision of social protection for workers and macro-economic regulation. Finally, so as to ensure a lasting redistribution of defence resources to civilian needs, the entire process would be institutionalized under civilian, primarily parliamentary, control.

The liberal solution also calls for the replacement of strictly consumer goods conversion with a strategy that exploits the Soviet Union's comparative advantage in high-technology areas such as aviation, fibre optics and space exploration. The sale of these technologies abroad, it is hoped, could become an important source for much needed hard currency. These earnings could be applied either to infrastructure modernization or to the provision of consumer goods. Such a strategy would require the elimination of those long-standing secrecy regulations which prevent the transfer of non-vital defence technologies to civilian use. Additionally, it would require the assistance of Western finance, technology and know-how. As many liberal economists are aware, however, such cooperation is unlikely to occur without parallel efforts to bolster investor confidence: for example, a more reliable guarantee of profit repatriation for foreign investors.

Predictably, the liberal plan has been criticized by conservative elements within the military-industrial establishment. In the view of top military officials, the strategy of transferring defence enterprises to civilian control would undermine the country's future defence potential. The military is also cool to the idea of Western assistance. As Marshal Akhromeyev has warned, such assistance risks becoming a dependency that "would allow foreign capital to dictate to us what the Soviet Union's foreign policy should be, and at what level the country's defence capabilities should be maintained."<sup>8</sup> While such arguments are often voiced by defence industry officials, their principal objection to the liberal programme is that it would provoke widespread plant closures and unemployment in an already suffering industry. As expressed in an open letter to *Pravda* in September 1990,

defence industry spokesmen maintain that, in present crisis conditions, the remedy for conversion lies instead in a renewed emphasis on plan discipline, privileged allocation, and traditional inter-ministerial ties.<sup>9</sup>

The *Pravda* letter signalled the start of a conservative retrenchment which continues to dominate Soviet conversion policy and indeed, the fate of economic reform as a whole. Further signs have been likewise discouraging. In December 1990, the long-awaited law on conversion was passed with surprisingly little fanfare. Although its detailed provisions have yet to be made public, the law is clearly based on the conservative approach: conversion remains a top-down process based on the current state-order system within the confines of the central ministries. While it places greater emphasis on the development of dual-use technology, the legislation still defines conversion primarily in terms of consumer goods production. Indeed, its sole innovation appears to be a promise of guaranteed social protection for defence industry employees.

Another telling indication of the current prospects for conversion is the 1991 defence budget. According to preliminary estimates announced in the fall of 1990, the 1991 defence budget was to be 65 billion roubles, down 5 billion roubles from 1990. However, the final budget was fixed at 96.5 billion roubles, which is a nominal increase of some 26 billion roubles. Defence officials have sought to fend off criticism of this increase by blaming it on inflation. They insist that in absolute terms, defence spending has been reduced as intended previously. As defence critics have pointed out, however, no other budget items have been adjusted accordingly. Moreover, in real terms, the total share of defence in the national budget has in fact increased from 25% to 35%.

This conservative trend has been reinforced by a Soviet military made uneasy by the display of American high-technology weaponry during the Persian Gulf War. In response to that event, there has been a marked increase in the Soviet military's insistence on parity in arms reductions. It would also appear that instead of turning guns into butter, the Soviet government is now seeking to trade guns for butter. In a recent trade deal with China, the Soviet Union is reported to have authorized the sale of an unspecified number of SU-27 fighter planes in return for a \$750 million commodity credit for the purchase of foodstuffs and consumer goods.<sup>10</sup> There is no indication that this sale of military goods is intended to bring in technology or financing to assist conversion, which is the rationale behind Czechoslovakia's pending sale of tanks to Iran and Syria.<sup>11</sup> As such, there is a danger that Soviet arms exports, like their



American counterparts, may increasingly provide a life-support function for the over-extended defence industry and serve as an indefinite substitute for genuine defence conversion.

## CONCLUSION

If current trends continue, Soviet conversion is unlikely to overcome the difficulties of the last two years. As practice has demonstrated, any effort to reduce the massive military burden on the collapsing civilian economy must go beyond palliatives to address the root cause of the country's economic malaise: the dysfunctional system of central planning. Contrary to initial expectations, the command system has proven itself unable to effect even a relatively smooth transfer of defence resources to civilian production. Indeed, the Soviet system seems even less conducive to conversion than any market economy. As long as conversion remains subject to the *diktat* of central ministries, no amount of tinkering is likely to create the necessary financial incentives, or lessen the extent of unchecked political intrusion, which would enable conversion to go forward. Thus far, conversion has only served to reinforce the extensive influence of the military-industrial complex over civilian resources without producing any significant benefits for the civilian economy.

The future prospects for conversion are not entirely bleak. The official commitment to conversion, though muted at the moment, has not been withdrawn. More significantly, the underlying economic trends which prompted conversion two years ago have only intensified. Perhaps in recognition of this fact, the Soviet government has indicated recently that more legislation on conversion is pending. Furthermore, new hope for conversion is found in recent proposals — suggested by both defence industry officials and their critics — for a third-way remedy for conversion. This approach speaks of breaking up the monopoly control of the centralized defence ministries in favour of a system still based on state ownership, but in which defence enterprises would be finally free of central planning. Ultimately, however, the fate of Soviet defence conversion will depend on the outcome of the broader, more vital struggle over the future orientation of the Soviet economy.

## NOTES

- 1 Quoted in Andrew S. Weiss, "Conversion of Soviet Defence Industries: A Preliminary Assessment," *Soviet Observer*, Vol.2, #2, December 1990, p. 1. This is the dominant interpretation of 'conversion' in the West as well, see: Seymour Melman and Lloyd J. Dumas, "Bombs into Ploughshares —

- Planning For Economic Conversion," *The Nation*, 16 April 1990, p. 1.
- 2 United Nations, *The Relationship between Disarmament and Development*, New York, 1982, p. 101.
- 3 Officially, the Soviet defence burden is currently 8% of GNP. Both Soviet defence critics and Western analysts reject this as too low. According to a committee of the USSR Supreme Soviet, when hidden costs are included, the real burden is closer to 20% of GNP, a figure generally accepted by Western analysts. See: Yuri Ryzhov, "The Security We Do Not Need," *New Times* #10, 1990, p. 27.
- 4 Arthur Alexander, *The Conversion of Soviet Defense Industry*, Rand P7620, Santa Monica, CA, January 1990, p. 10.
- 5 The draft conversion legislation was officially made "classified information". Even the Soviet parliamentary committee responsible for defence and security issues was not privy to the draft's contents. See: Gyorgy Arbatov, "Why Does Parliament Lack Military Data?," *Isvestiya*, 25 October 1990, p. 3, reprinted in *Current Digest of the Soviet Press*, Vol. 42, #43 (1990), p. 116.
- 6 Quoted in Yuri Adamov, "Economic Reform and Conversion," *International Affairs* (Moscow), January 1990, p. 116.
- 7 Vladimir Lopatin, "The Army and The Economy: Economic Aspects of Military Reform," *Global Affairs*, Winter 1991, p. 15.
- 8 Quoted in *Foreign Broadcast Information Service FBIS*, Daily Report: Soviet Union, 19 September 1990, p. 15.
- 9 "Status For the Defence Industry," *Pravda*, 6 September 1990, p. 2, reprinted in *Foreign Broadcast Information Service FBIS*, Daily Report: Soviet Union, 10 September 1990, pp. 68-70.
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- 11 "Hard-Pressed Czechs Retain Arms Trade," *New York Times*, 3 May 1991, p. A3.

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